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The insecurity of intellectual property licenses during insolvency proceedings

October 2016
Intellectual property
Patents

A recent Saskatchewan Court of Queen's Bench decision allowed a court-appointed receiver to sell and transfer intellectual property rights free and clear of encumbrances, finding that a license to use improvements of an invention was a contractual interest and not a property interest.[1] This case highlights the insecurity of a licensee's rights in a court-appointed receivership.

Background

The inventor of a novel method of using mass spectrometry to analyze complex biological samples filed a Canadian patent application in 2000 covering the invention and a corresponding application under the Patent Cooperation Treaty in 2001. This inventor incorporated Yol Bolsum Canada Inc. ("**YBCI**"), of which he was also the president and controlling shareholder, and he assigned the invention to YBCI. He also incorporated Phenomenome Discoveries Inc. ("**PDI**") as a wholly owned subsidiary of YBCI. YBCI granted PDI an exclusive license to use the invention, and in turn PDI granted YBCI a 99-year, non-exclusive grant-back license to practice any improvements to the invention. This agreement provided that in the event of PDI's winding up or entering into receivership, YBCI could terminate the agreement and demand a transfer and assignment of all improvements made to the invention.

This inventor was also involved with the operations of PDI as its president and CEO, under a management services agreement between YBCI and PDI. The relationship between the inventor and PDI was also governed by a Non-Competition and Intellectual Property Agreement ("**NCIP Agreement**"), which provided that PDI would acquire all intellectual property rights generated while the inventor worked for PDI.

The venture capital fund Golden Opportunities Fund Inc. ("**GOFI**") began investing in PDI in 2002 and owned around 10% of PDI's equity. In December 2015 PDI was put into interim receivership when GOFI called in its debenture after a change in corporate governance. The court appointed a receiver in February 2016 and ordered a sales procedure, which resulted in only one bidder, Med-Life Discoveries ("**Med-Life**"). Med-Life had previously purchased certain PDI assets in 2015 using funds partly provided by GOFI.

The receiver then sought court approval for the sale of PDI's assets and an order vesting PDI's assets in Med-Life free and clear of encumbrances. YBCI objected and sought a stay of the order, pending a determination of YBCI's interest in PDI's property, on the basis that YBCI was given a license to practice improvements to the invention.

The court's decision

The court found that the license given by PDI to YBCI to practice improvements to the invention only created a contractual right and not a property right, relying on a 2008 Ontario Superior Court of Justice case.[2] Moreover, the court held that the statutory provisions protecting a grantee's right to use intellectual property when the agreement granting the right is terminated in the context of insolvency proceedings[3] only apply to proposals made to creditors and not to the actions of court-ordered receivers. As such, the court held that PDI's assets could be sold free and clear of encumbrances and that YBCI was only entitled to pursue a claim against the net sale proceeds for the value of its license.

The court also refused to exercise its discretion to grant YBCI a license to practice improvements to the invention because it found that the inventor bargained away YBCI's rights to the improvements when he knowingly signed the NCIP Agreement giving PDI ownership rights to all improvements.

Commentary

It is important to keep in mind the potential for insolvency when structuring intellectual property licenses.

First, the courts have been divided on the nature of intellectual property rights granted in a license, which will affect the survivability of such rights during insolvencies. Exclusive marketing rights to a film were found to be property rights,[4] while a trademark license agreement was held to grant contractual rights rather than proprietary interests.[5] When possible a property interest accompanying the license should be obtained.

Second, this decision highlights the lack of statutory protection for intellectual property use agreements in the event of receivership, despite the 2009 amendments to the *Bankruptcy and Insolvency Act* and *Companies' Creditors Arrangement Act* extending such protection to creditor proposals.[6]

Third, parties to a license should be cautious when entering into an agreement that may restrict ownership of subsequently arising intellectual property rights. Here the self-dealing by the inventor had a significant equitable effect on the result.

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Footnotes

1 *Golden Opportunities Fund Inc v Phenomenome Discoveries Inc*, 2016 SKQB 306.

2 *Royal Bank of Canada v Body Blue Inc* (2008), 42 CBR (5th) 125 (Ont SCJ).

3 *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s 65.11(7); *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, s 32(6).

4 *Re Erin Features #1 Ltd* (1991), 8 CBR (3d) 205 (BCSC).

5 *Re T Eaton Co* (1999), 14 CBR (4th) 288 (Ont Sup Ct J).

6 *Supra*, note 3.

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